SUPREME COURT, U.S.
FILED
JUN 30 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1160

IN THE

Supreme Court of the United States

October Term, 1987

DUQUESNE LIGHT COMPANY AND
PENNSYLVANIA POWER COMPANY,
Appellants,

v.

DAVID M. BARASCH, CONSUMER ADVOCATE, *ET AL.*,
Appellees.

On Appeal from the
Supreme Court of Pennsylvania

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

WILLIAM PAUL RODGERS, JR.
General Counsel
(Counsel of Record)

CHARLES D. GRAY
Assistant General Counsel

National Association of
Regulatory Utility Commissioners
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044
(202) 898-2200

June 30, 1988

Counsel for Amicus Curiae

CASILLAS PRESS, 1717 K STREET, N.W., WASHINGTON, D.C., 20036

32 pp

TABLE OF CONTENTS

	Page
INTEREST OF AMICUS CURIAE.....	1
SUMMARY OF ARGUMENT.....	5
ARGUMENT.....	9
The Court Should Not Adopt A Specific Ratemaking Methodology As The Constitutional "Benchmark"..	11
CONCLUSION.....	28

TABLE OF AUTHORITIES

Cases: Page

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959).....14

Barasch v. Pennsylvania Public Utility Commission, 532 A.2d 325 (Pa. 1987).....3

FERC v. Mississippi, 456 U.S. 742 (1982).....20

FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944).....passim

FPC v. Natural Gas Pipeline Co., 315 U.S. 575 (1942).....12,13,22

Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (D.C. Cir. 1987).....18,19,22,23

Munn v. Illinois, 94 U.S. 113 (1877).....14

Permian Basin Area Rate Cases, 390 U.S. 747 (1968), reh. den. 392 U.S. 917 (1968).....passim

Washington Gas Light Co. v. Baker, 188 F.2d 11 (D.C. Cir. 1950).....16

Wisconsin v. FPC, 373 U.S. 294 (1963).....14-15

Statutes:
16 U.S.C. Sec. 2523(b)(5) (1985).....20

Miscellaneous:
Drobak, From Turnpike to Nuclear Power: Constitutional Limits on Utility Rate Regulation, 65 B.U.L.R. 65.... 21

Rodgers and Gray, State Commission Treatment of Nuclear Plant Cancellation Costs, 13 Hofstra L.R. 443 (1985)..... 21

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1987

No. 87-1160

DUQUESNE LIGHT COMPANY AND
PENNSYLVANIA POWER COMPANY,
Appellants,

v.

DAVID M. BARASCH, CONSUMER ADVOCATE,
ET AL.,
Appellees.

On Appeal from the
Supreme Court of Pennsylvania

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF APPELLEES

INTEREST OF AMICUS CURIAE

The National Association of Regulatory Utility Commissioners (NARUC) submits this brief as amicus curiae urging affirmance due to the substantial harm reversal of the decision below may have upon the regulation of public utilities by its member State regulatory commissions. The NARUC files this brief with the written consent of the

Appellants and the Appellees.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the fifty States, and the governmental agencies of the District of Columbia, Puerto Rico, and the Virgin Islands engaged in the regulation of utilities and carriers. The Pennsylvania Public Utility Commission (PUC), an Appellee herein, is a member commission of the NARUC. The mission of the NARUC is to serve the public interest by seeking to improve the quality and effectiveness of public regulation in America.

More specifically, the NARUC contains the State officials charged with the duty of regulating natural gas, electric and communications utility companies operating within their respective borders. As such, these officials have the obligation to assure the establishment and operation of utility companies which serve the public

interest. This means that State commissions, constituted as creatures of their respective legislatures, must seek to ensure that dependable and safe utility service is provided consumers at rates which are just, reasonable and nondiscriminatory.

In the decision on appeal, the Pennsylvania Supreme Court held that a Pennsylvania statute--Act 335 as incorporated into Section 1315 of the Pennsylvania Public Utility Code, 66 Pa. C.S. Sec. 1315--denied Duquesne Light Company and Pennsylvania Power Company (Appellants) the ability to recover their costs in cancelled nuclear power plants from their electric consumers.[1] Appellants have appealed this decision to this Court on the ground that the Pennsylvania

---

[1]The decision of the Pennsylvania Supreme Court appears at Appendix A to the Jurisdictional Statement. Subsequent reference will be made to the decision as it appears therein in this form. App. at ___. The case, entitled Barasch v. Pennsylvania Public Utility Commission, is reported at 532 A.2d 325 (Pa. 1987).

Court's construction of Act 335 to deny recovery of plant cancellation costs constitutes a taking of property without compensation and therefore violates the utility ratemaking standards established by this Court in FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) (Hope) and its progeny.

In support of Appellants, two parties have submitted briefs as amicus curiae supporting reversal and further, urging the Court to make substantial revisions in its Hope jurisprudence. The Edison Electric Institute (EEI), believing that the Pennsylvania Supreme Court relied on "outmoded ratemaking concepts", urges the Court to reconsider the application of the "used and useful" doctrine by regulatory commissions. The Pennsylvania Electric Association (PEA) proposes a more radical transformation of the constitutional requirements of utility ratemaking by urging the Court to hold that regulatory commissions must use the "prudent

investment test as the constitutional benchmark" for utility ratemaking.

If adopted by the Court, the EEI and PEA positions would have a profound impact on the NARUC and its member commissions. Simply put, adoption of these amicus arguments would replace the "end result" test of Hope with this Court's prescription of constitutionally acceptable and unacceptable ratemaking policies and practices. Contrary to the position of amici, Hope has provided regulatory commissions with the flexibility necessary to strike appropriate balances of ratepayer and investor interests in utility-specific cases. Therefore, the NARUC's interest in addressing the EEI and PEA arguments is strong, compelling its participation in the case at bar.

SUMMARY OF ARGUMENT

It is well-settled in the law of regulation that regulatory commissions are obliged by law to regulate public utilities

to ensure that the rates they establish are just and reasonable for both utility investors and consumers. The just and reasonable standard, while codified in the provisions of State and Federal regulatory statutes, has been found by this Court to satisfy the constitutional requirement precluding regulatory commissions from exercising their ratemaking authority in a manner that confiscates utility assets. Permian Basin Area Rate Cases, 390 U.S. 747, 770 (1968), reh. den. 392 U.S. 917 (1968). That is to say, rates found to be "just and reasonable" for statutory purposes do not constitute a taking under the Constitution. Id.

Therefore, the total revenues to be earned by a utility from the sale of its services pursuant to commission-established rate levels are permissible if such revenues fail within the "zone of reasonableness" bounded at the lower end by the constitutional prohibition against confiscation and at the

upper end by the statutory prohibition against the exploitation of utility consumers through the exercise of monopoly pricing powers. Permian Basin Area Rate Cases, 390 U.S. at 770. The phrase "just and reasonableness" is of course general, leaving to regulators the obligation to develop ratemaking methodologies to ensure that the total return a utility earns for providing public service is neither confiscatory or exploitive.

In its decision in FPC v. Hope Natural Gas Co., (Hope), 320 U.S. 591 (1944), this Court determined that the ratemaking methodologies employed by regulatory authorities are not "important" in a constitutional sense if the result of the ratesetting process is a "just and reasonable" rate order. Hope, 320 U.S. at 602-603. By their amicus briefs filed in this case, however, EEI and PEA seek the Court's review of the means by which commissions

establish utility rates whether or not the "end result" of the ratemaking process is within the constitutionally permissible zone of reasonableness. As such, these parties seek not the proper application of the Hope test to Pennsylvania's ratemaking actions; rather, they seek Hope's abandonment by a decision of the Court which describes and defines both constitutionally acceptable and constitutionally suspect ratemaking methodologies.

The invitation to abandon Hope must be rejected. For over forty years, the "end result" test created in that case has proven to be a workable standard enabling regulatory commissions to flexibly and appropriately balance the interests of utility ratepayers and investors. There is no basis for the Court to grant utilities a new constitionally mandated entitlement to their chosen ratemaking methodology. Rather, if the "total effect" of a ratesetting

exercise is not "unjust and unreasonable", the regulatory decision is, and must remain, constitutional. Hope, supra, at 602.

ARGUMENT

In the decision before the Court, the Pennsylvania Supreme Court ruled that Act 335 prohibited the PUC from allowing electric utilities to recover from their ratepayers the costs of plant not "used and useful" in providing electricity. App. at 15a. As a result, utilities subject to Act 335, such as Appellants, were prohibited from including the costs of cancelled nuclear plants in their respective rate bases (thereby denying them a profit from their failed investments) and from recouping cancellation costs as operating expenses through amortization. Id. Appellants contend that the application of the "used and useful" test to deny a return of their cancellation costs constitutes a taking of their property without compensation in violation of Hope.

Amici in support of Appellants urge the Court to go beyond the arguments of Appellants by suggesting that the Court should replace the "end result" test of Hope with a system of judicial review which prescribes the procedures and methodologies regulatory commissions must use to establish utility rates which are "constitutional". Specifically, the Pennsylvania Electric Association (PEA) proposes that the Court require that ratemaking agencies "adopt the prudent investment test ... as the constitutional benchmark." PEA Br. at 21-23. A commission departing from PEA's preferred ratemaking methodology would bear the affirmative burden of justifying the use of any other ratemaking procedures as constitutionally acceptable. Id. at 23. While more circumspect than PEA, the amicus brief of the Edison Electric Institute (EEI) also invites the Court to review the methodologies of the ratemaking process.

While paying lip service to the Hope standard, EEI argues that the "used and useful" concept is constitutionally suspect if a regulatory commission uses original cost rate base valuation methods. EEI Br. at 15-16.

The NARUC submits that these suggestions, which would radically revise the Hope standard applicable to the decisionmaking processes of each of its member commissions must be soundly rejected.

The Court Should Not Adopt A Specific Ratemaking Methodology As The Constitutional "Benchmark"

In Hope, this Court established the standard by which the ratemaking decisions of each regulatory commission--State and Federal--are to be judged:

> It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.

Hope, supra, at 602.
(emphasis supplied)

This language in Hope was presaged in FPC v. Natural Gas Pipeline Co., 315 U.S. 575 (1942) when the Court held that

> The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.
> 315 U.S. at 586.
> (emphasis supplied)

Taken together, Natural Gas Pipeline, supra, and Hope provide regulatory commissions with broad flexibility to use various "formulas or combinations of formulas" to arrive at a utility rate order that is just and reasonable in both a statutory and

constitutional sense.

In turn, the role of courts in reviewing ratemaking orders is limited: (1) to ensuring that the ratemaking agency acted with proper statutory authority; (2) to ensuring that a rate commission's order is reasoned and based upon substantial evidence; and (3) to ensuring that an order, taken as a whole, results in rates that are just and reasonable, i.e. that fall within the zone of reasonableness bounded by the competing interests of investors and the consuming public. Permian Basin Area Rate Cases, 390 U.S. 747, 791-792 (1968). However, in the modern era of this Court's ratemaking jurisprudence that began with Natural Gas Pipeline, this Court has not found that the Constitution demands more of a regulatory commission--as a matter of substance--than that the total effect of a rate order strike a balance between the interests of investors in fair compensation for their

utility investments and the interests of consumers in paying rates free from the abuse of monopoly pricing power.[2]

Therefore, under decisions of this Court, the substance of a ratemaking methodology whether adopted, reconsidered, amended or abandoned by a regulatory commission does not rise to the level of constitutional significance. Wisconsin v. FPC, 373 U.S.

---

[2]The Court in Hope, faced with allegations that natural gas rates had been set too low by the Federal Power Commission, not surprisingly devoted its attention to a description of the investor interest in the "financial integrity" of the regulated utility. 320 U.S. at 603. The very purpose of both State and Federal regulation, however, is the protection of utility consumers from exploitation at the hands of a monopoly. Regulatory statutes, such as the Natural Gas Act under consideration in Hope, were enacted "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 388 (1959). States, acting through regulatory commissions created by their respective legislatures, employ their inherent police powers to protect their citizens under statutes similar in scope and purpose as federal regulatory enactments. Munn v. Illinois, 94 U.S. 113 (1877).

294, 309 (1963). As explained in Permian Basin, supra, the sole substantive inquiry appropriate for a reviewing court is the third ground for judicial review: the assessment of the total effect of a rate order on the competing interest of investors and consumers. 390 U.S. at 792.

PEA would have this Court overrule the Hope standard of constitutional analysis by substituting a single rule of ratemaking--the "prudent investment standard". EEI submits that the application of the "used and useful" doctrine to an original cost rate base is unconstitutional. Both apparently believe that the action of Pennsylvania in this case justifies the abandonment of Hope and the rejection of the multitude of ratemaking practices and procedures established by State and Federal commissions in reliance upon that decision. For at least the following reasons, these amici are wrong.

1. Contrary to the positions of PEA and EEI, the "used and useful" principle employed by the Pennsylvania Court is neither "irrelevant" (PEA Br. at 16), "fundamentally unbalanced" (EEI Br. at 11)[3] nor otherwise constitutionally suspect. Rather, it is one of many ratemaking standards employed by individual ratemaking commissions to calculate a given utility's overall revenue requirement, i.e. the total revenues a utility is given the opportunity to earn in order to recover its costs of service

---

[3]In its brief, EEI repeatedly states that "used and useful" has no "constitutional significance" (EEI Br. at 12, n. 14) nor is constitutionally required. While true, these statements seek to confuse the issue. The question is not whether "used and useful" is constitutionally required, but rather, whether the "concept" is constitutionally permissible. Under Hope, "used and useful" is no more or less required or permissible than any other ratemaking methodology used by a ratemaking body. Unlike PEA, which finds Pennsylvania's used and useful per se unconstitutional (PEA Br. at 9-10), EEI concedes that "used and useful" is a "permissible tool of ratemaking". EEI Br. at 12, n. 14, citing Washington Gas Light Co. v. Baker, 188 F.2d 11 (D.C. Cir. 1950).

and compensate its investors. As such, it is of no more consequence in a constitutional sense than the methodology used by a commission to calculate return on equity, allocate the costs of a multistate utility among various jurisdictions, estimate the number of calls connected by a local telephone company, or phase in the cost of an expensive power plant to mitigate precipitous rate increases to consumers. Each of these essentially mathematical calculations must be reasoned and supported by substantial evidence, Permian Basin, supra at 792, but the application of none of these factors--standing alone--directly results in an unconstitutional taking of the property of utility investors. EEI argues that "the 'used and useful' test is not necessarily consistent with the Hope criteria." EEI Br. at 13. A better statement of the law is that standing alone, the "used and useful" test is simply without constitutional importance under the Hope

test.

However, the "used and useful" test serves important regulatory purposes--and not the "generalized ... consumer interest in having lower and more affordable rates (PEA Br. at 20)--which would be lost should the Court abandon the Hope standard in favor of a 'prudent investment' methodology." The test provides regulatory commissions with the power to allocate the inherent risks of the utility business between utility shareholders--who assume investment risks when they purchase stock--and ratepayers who seek nothing but affordable and reliable service. Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1190 n.1 (D.C. Cir. 1987) (Starr, J. concurring) ("The 'used and useful' rule operates as a restraining principle, reminding utility management that they must assume the risk of economic forces working against an investment which is prudent at the time it is made.")

Adoption of the prudent investment test as the "constitutional benchmark" for utility ratemaking would effectively foreclose the ability of regulators to allocate the risks of plant failure between shareholders and ratepayers. As Judge Starr ably described in Jersey Central, supra, the prudent investment rule shifts the risks of construction--including the risk of bad management--to ratepayers thereby effectively insulating the utility and its investors from the vicissitudes of the market. 810 F.2d at 1190-91. Moreover, the test proposed by amici would require that ratepayers pay for investments providing them "no discernible benefit." Id.

In fact, beyond the issue of risk allocation, the "used and useful" test serves the entirely appropriate and important public purpose of ensuring that ratepayers not support financially utility investments having nothing to do with utility service.

Utilities may invest in nonregulated subsidiaries operating computer companies, baseball teams or cable television systems and under a prudent investment standard, charge ratepayers for their investments on the grounds that it is "prudent" for a utility to diversify its businesses in a volatile economy. On a more mundane level, a prudent investment test might well guarantee a utility the right to recover from ratepayers the costs of promotional advertising, political or charitable contributions, country club dues and the like.[4]

In sum, the used and useful test is a valuable and legitimate regulatory tool which is neither unconstitutional per se

[4]There is a certain irony here in that amici advocate a constitutional ratemaking test which would require the recovery of utility costs which the Congress has determined should not be charged to ratepayers. See Section 113(b)(5) of the Public Utility Regulatory Policies Act of 1978, codified at 16 U.S.C. Sec. 2623(b)(5) (1985) (denying ratepayer support for "promotional or political advertising"); FERC v. Mississippi, 456 U.S. 742 (1982).

nor when applied to achieve a just and reasonable end result. Hope, supra.

2. The NARUC submits that this case is clearly an inappropriate vehicle for the Court to jettison Hope in favor of a new prudent investment standard having Nationwide application.[5] Simply put, neither Appellant utility companies nor their supporting amici have shown or alleged that the decision

[5]While the facts of this case involve the question of cost recovery for cancelled plants, a prudent investment test as advocated by amici would apply to all investments of all types of utilities. It is for this reason that the NARUC is deeply concerned about the implications of amici's farreaching arguments which would place a constitutional straitjacket on each NARUC member commission. Under Hope, regulatory commissions use a variety of procedures and methodologies to discharge their responsibility to protect the public interest. For example, on the cancelled plant issue, State commissions have developed a broad spectrum of policies and procedures to allocate the risks and burdens of failed utility investments. See Rodgers and Gray, State Commission Treatment of Nuclear Plant Cancellation Costs, 13 Hofstra L.R. 443 (1985) and cases therein cited. See also Drubak, From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation, 65 B.U.L.R. 65, 112-119 (1985).

of the Pennsylvania Court creates any financial distress or has otherwise taken the value of any of their shareholders' investments. Indeed, as the Pennsylvania Public Utility Commission recounts in its brief as Appellee, the decision of the Pennsylvania Court will have a "total effect" of less than 1 per cent on Appellants' overall revenues when applied to the underlying rate order of the State commission. Br. of PUC at 35.[6] Given these facts, Appellants have not shown that their respective rate levels have fallen below the "zone of reasonableness" described in Natural Gas Pipeline, supra, 315 U.S. at 585-586. Nor have they shown that the Pennsylvania

[6]In Jersey Central Power & Light, supra, the utility was able to allege financial distress sufficient to entitle it to a hearing on its taking claim, but not necessarily any recovery of its cancelled plant costs. 810 F.2d at 1170-71. Until Jersey Central provided factual proof of confiscation under the "consequences of the rate order" the Court had no basis to order a profit on the disputed costs. Id. at 1181.

Court's decision has improperly denied them sufficient revenues "for operating expenses but also the capital costs of business." Hope, supra, 320 U.S. at 603.

Therefore, there is simply no need for the Court to adopt a new ratemaking standard through its decision in this case. Contrary to EEI's unsubstantiated assertions (EEI Br. at 13-14), there is no imminent financial crisis in the electric utility industry caused by a failure of regulatory commissions to conscientiously discharge their responsibilities. There is clearly no warrant for this Court to require a ratemaking standard "weighted in favor of the utility"[7] to be applied by all State and Federal regulators for all utilities.

3. Finally, this Court's creation of a constitutional "benchmark" for utility rate regulation will not, as PEA suggests,

[7]Jersey Central Power & Light, supra, at 1190.

"protect this Court's docket from the burden of reviewing the details of a plethora of rate decisions". PEA Br. at 23.[8] Rather, a decision of the Court which creates constitutional standards for assessing individual ratemaking methodologies will only increase the burden on this and other courts. First of all, if the prudent investment standard is the "constitutional benchmark", every departure by a regulatory commission will be a constitutional question for reviewing courts to decide. Moreover, such litigation will not be limited to the overall effect of a rate order as is now the law under Hope;[9] rather, utilities will be able to seek judicial review of discrete determinations--such as the calculation of

[8]PEA's proposes that commissions bear the burden of "affirmatively demonstrating" the validity of other non-favored ratemaking mechanisms. PEA Br. at 23. Of course, under standard regulatory practice, a utility seeking increased revenues bears the burden of proof on each relevant issue.

[9]Permian Basin, supra, 390 U.S. at 792.

rate base--regardless of their financial health or their overall earnings. Further, we do not understand PEA to argue that the "total effect" of a rate order would be unreviewable even if the commission issuing the order faithfully applying the prudent investment standard. Therefore, utilities would have more, rather than fewer, issues to take to court.

Second, adoption of a prudent investment rule could only increase the number of ratemaking cases in which management prudence--an exceedingly complex inquiry--is at issue. Inevitably, parties seeking relief from high utility rates would aggressively litigate the prudence question--their only real alternative under PEA's proposed ratemaking test--thereby burdening courts and commissions with issues whose outcome would have no real bearing on the financial welfare of investors.

Third, a decision of the Court creating

a prudent investment standard for rate base valuation would without doubt open the flood gates for litigation of the "constitutionality" of other ratemaking mechanisms. Perhaps the next case to come before the Court would involve a utility's suggestion that the discounted cash flow method of calculating return on equity is the only constitutionally permissible standard. Or the next appellant may argue that the Constitution requires that utility property with a useful life of five years or less be expensed rather than capitalized. The point here is that once the Court starts down the path of deciding what are acceptable and unacceptable ratemaking methodologies, such items as regulatory accounting standards, operating expense calculations, indeed the very details of ratemaking, become subject to constitutional scrutiny in the State and Federal courts.

In sum, by seeking to raise a discrete

ratemaking calculation to independent constitutional significance, Appellants and their amici would engraft a new substantive due process jurisprudence on utility ratemaking to stand along side the objective Hope standard. By so doing, these parties would create more litigation, more confusion, and direct involvement of the courts in the ratesetting process. The NARUC respectfully submits that such an outcome is clearly unwarranted in the context of this proceeding. The Hope standard has served the public interest well. It should not be discarded, abridged or revised.

CONCLUSION

This Court should affirm the judgment below.

Respectfully submitted,

WILLIAM PAUL RODGERS, JR.
General Counsel
(Counsel of Record)

CHARLES D. GRAY
Deputy Assistant General Counsel

National Association of
Regulatory Utility Commissioners
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044
(202) 898-2200

Attorneys for Amicus Curiae